

8000 INTEREST & PENALTIES

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8010 SUMMARY OF PENALTIES

The California Revenue and Taxation Code contain numerous provisions for the assessment of penalties in various situations where taxpayers have failed to comply with the law. Among these provisions are penalties for delinquent filing, underpayment of estimated taxes, failure to furnish information/returns, and failure to file. There are also provisions for waiving penalties under certain circumstances.

It is the auditor's responsibility to be familiar with the penalty sections of the law and to apply them uniformly.

Effective January 1, 2002, where penalties are being assessed, Revenue & Taxation Code Section 19187(b)(1) requires that the imposition of the penalty is personally approved in writing by the immediate supervisor of the individual making that determination or a higher level designated official.

8020 DELINQUENT PENALTY (SECTION 19131)

The delinquent penalty is assessed on any corporation that fails to file a return on or before the due date or extended due date. The penalty is assessed on the net amount of the tax due on the return.

APPLICATION

The penalty is assessed at the rate of 5 percent of the tax for each month, or a fraction of a month, elapsing between the due date of the return (determined without regard to any extension of time for filing) and the date on which filed, but the total penalty shall not exceed 25 percent of the tax. In the case of a commencing corporation, the penalty shall apply to all tax accruable on the due date of the return.

The delinquent penalty may be increased or decreased based on adjustments to tax after the original return is filed.

***** , to determine the due date of the return and the date it was filed.

WAIVER

This penalty can be waived if the corporation submits a written statement listing the facts which support reasonable cause for failing to file the return by the original due date. (See **MAPM 8030**)

EXCEPTION

This penalty should not be assessed if an underpayment penalty is being assessed which results in a larger penalty. (See **MAPM 8110** for the underpayment penalty.)

NOTE: ((* *)) = Indicates confidential and/or proprietary information that has been deleted.

8030 REASONABLE CAUSE FOR THE WAIVING DELINQUENCY PENALTY

The delinquency penalty is assessed unless there is reasonable cause and no willful neglect.

The following acceptable/unacceptable reasons are intended to be used as a guideline for purposes of uniform treatment and clarification. Auditors will continue to use their judgment in borderline and exceptional cases and, if necessary, should refer the matter to their supervisor or other designated reviewer.

Generally, information submitted by the taxpayer for reasonable cause will be acceptable in letter form; but, in cases of doubt or where evidence of mailing is required, an affidavit should be requested setting forth reasons for late filing.

GENERALLY ACCEPTABLE REASONS:

- Death, or severe illness of the officer, or qualified representative or employee responsible for submitting or completing the return.
- California return sent on time to the Director of the Internal Revenue Service.
- Request for exemption is in process.
- Records are in litigation.

GENERALLY UNACCEPTABLE REASONS:

- Confusion of the due date because of the State income tax filing date.
- Belief that a return was not required because of inactivity or operation at a loss.
- Payment of the tax by the due date but failure to file a return.
- Thought the corporation was exempt or dissolved.
- Failure to receive forms because of change of address or otherwise.
- Change of fiscal year caused filing of delinquent return.
- Confusion as to the correct incorporation date.

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- Lack of funds to pay the tax.

8040 PENALTY FOR FAILURE TO FURNISH INFORMATION/FILE ON DEMAND (SECTION 19133)

When the taxpayers and representatives fail or refuse to furnish information requested in an audit (**MAPM 5030**), a formal demand for information should be served. This is appropriate when a response to a request for information is unreasonably delayed, incomplete, refused or ignored.

It is essential that auditors reevaluate the relevance and need for any missing information before making a formal demand. Has the relevance of the request been verbally discussed with the taxpayer? Is the request reasonable? Has the information already been provided but in some alternative format? Are other alternatives available? Is the representative's failure to provide the requested information due to reasonable cause?

If a demand is necessary, the formal demand must make reference to the unanswered request, the specific information requested and the necessity for the information. Reference must also be made to the imposition of the failure to furnish information penalty under R&TC §19133.

The failure to furnish information penalty should be assessed in cases where the formal demand is refused or ignored. The penalty is to be applied uniformly where (1) the information has been clearly requested in writing along with an explanation of the need for and relevance of the information, and (2) a formal demand has been served.

If the audit requests are not documented or the appropriate request and demand for information have not been made, any recommendations to assess the penalty based on a lack of taxpayer cooperation or refusal to furnish information will not be accepted.

Effective 1/1/2002, the immediate supervisor's approval is required anytime a failure to furnish information penalty is assessed. For significant audits including the Fortune 500 or other large audits, the supervisor may want to keep the program manager informed.

APPLICATION

The penalty for failure to furnish information is 25% of the deficiency imposed that relates to the requested information. The penalty for failure to file on demand is 25% on the lesser of the assessment, without regard to refundable credits, or the tax shown on the return when filed.

WAIVER

This penalty can be waived if the corporation submits a written statement listing the facts that support

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reasonable cause for failing to file a return upon notice and demand. (See **MAPM 8050** for more information.)

8050 REASONABLE CAUSE FOR WAIVING THE PENALTY FOR FAILURE TO FURNISH INFORMATION ON DEMAND/FILE ON DEMAND

In order to waive the penalty, the taxpayer or representative must show that the failure is due to reasonable cause and not willful neglect. The following items are intended as a guide for purposes of uniform treatment and clarification. Auditors must use their judgment in borderline and exceptional cases and, if necessary, should refer the matter to their supervisor or other designated reviewer.

GENERALLY ACCEPTABLE REASONS:

- When the representative is able to furnish evidence that the notice and demand was not received; however, an unsupported statement by the representatives that they did not receive the notice and demand will generally not be considered a reason for waiving the penalty.
- Where special circumstances make imposition of the penalty clearly inequitable.
- The destruction or impounding of records so that a return cannot be prepared and filed.
- Erroneous written advice by a representative of FTB.

Similar circumstances that warrant waiving penalties may be considered in this category. However, undue delay after a taxpayer has been contacted may not be considered as reasonable cause.

8060 NEGLIGENCE PENALTY (SECTION 25934-35 -A REPEALED IN 1990)

The negligence penalty became the accuracy-related penalty under R&TC Section 19164 and IRC Section 6662 for taxable years beginning on or after January 1, 1990, and any other taxable year for which an assessment is made after the enactment date of July 16, 1991.

See **MAPM 8070** for the Accuracy-Related Penalty.

**8070 ACCURACY-RELATED PENALTY FOR SUBSTANTIAL UNDERSTATEMENT OF TAX
(SECTION 19164)**

California Revenue & Tax Code Section 19164 provides that the accuracy-related penalty is imposed on the portion of any underpayment of tax required to be shown on the return attributable to any of the following:

- Negligence
- Substantial understatement of tax
- Substantial valuation misstatement, or
- Substantial overstatement of pension liabilities.

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NOTE: ((* *)) = Indicates confidential and/or proprietary information that has been deleted.

8080 EXCEPTIONS TO THE ACCURACY-RELATED PENALTY FOR SUBSTANTIAL UNDERSTATEMENT OF TAX

The most common reason for imposing an accuracy-related penalty is for substantial understatement of tax. Before the auditor assesses the penalty, the amount of the understatement must be reduced by any portion of the understatement to which any of the following apply:

- There is “substantial authority” for the treatment claimed. This standard is met if the weight of the authorities supporting the tax treatment of an item is “substantial” in relation to the weight of the authorities supporting contrary treatment. The types of authorities that should be considered, and the relative weight to give to those authorities is described in Treasury Regulation Section 1.6662-4(d).
- The relevant facts affecting the item’s tax treatment are adequately disclosed in the return. Generally, such disclosure must be made on Federal Form 8275 or 8275-R attached to a return, or on a qualified amended return filed in accordance with the instructions in FTB Notice 1992-9 and FTB Notice 1992-12. Disclosure will not prevent imposition of the penalty if the tax treatment on the return is frivolous. (Treasury Regulation Section 1.6662-4(e), (f).)
- The regulations indicate that the most important factor to consider is the extent of the taxpayer’s effort to report the proper tax liability and whether the taxpayer acted with reasonable cause or in good faith. An honest misunderstanding of fact or law that is reasonable in light of the experience and knowledge of the taxpayer may satisfy the reasonable cause/good faith exception. Isolated computational or transcriptional errors are also not inconsistent with reasonable cause and good faith. Reliance on an erroneous information return, professional advice, or other facts may satisfy the exception if such reliance was reasonable under the circumstances. (Treasury Regulation Section 1.6664-4(b).)

If it appears that the imposition of an accuracy-related penalty for substantial understatement may be appropriate, the taxpayer should be advised of the exception and given an opportunity to present substantial authority or explain why reasonable cause is present.

8085 FRAUD (SECTION 19164(C))

If any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment that is attributable to fraud. The fraud penalty shall be determined in accordance with the provisions of IRC Section 6663.

If any portion of an underpayment is attributable to fraud, the entire underpayment shall be treated as attributable to fraud, except with respect to any portion of the underpayment that the taxpayer establishes (by a preponderance of the evidence) is not attributable to fraud.

Where the fraud penalty is assessed in a federal audit report, it may be proposed on a Notice of Proposed Assessment. However, it must be independently supported by facts, as the State carries the burden of proof as to its correctness. **The definition of fraud is the intent to evade tax.**

An auditor is required to obtain the approval of the unit supervisor when:

- The fraud penalty is imposed without prior federal action
- The fraud penalty was added for federal purposes and our adjustment is based upon the RAR, but the fraud penalty is not being imposed.

The penalty can be abated only if the corporation substantiates in writing that there was no intent to evade tax.

8100 FAILURE TO FILE ANNUAL STATEMENT (SOS PENALTY SECTION 19141)

Corporations are required to file an annual statement identifying its officers (Form SS100) with the Secretary of State.

If the officers fail to file an annual statement for two consecutive years, the following actions are taken:

- The Secretary of State (SOS) notifies the corporation of the possibility of suspension if a statement is not filed within 60 days.
- SOS suspends the corporation if the corporation does not comply within the 60 days.
- SOS notifies the FTB that the corporation is suspended. No penalty is yet assessed.
- FTB assesses the penalty against the corporation and sends the billing.
- The penalty amounts are \$250 for general and all foreign corporations, and \$50 for domestic nonprofit corporations.
- Interest is not charged on the penalty.

As a condition of revivor, a suspended corporation must furnish proof that the officer statement was filed with the SOS. The FTB is only the collection agency for this penalty. It does not have the authority to cancel or waive the penalty unless notified to do so by the SOS.

Questions regarding the assessment should be directed to the Office of Secretary of State, telephone number (916) 657-3537.

Taxpayers may access the Secretary of State via Internet at <http://www.ss.ca.gov/>

8110 UNDERPAYMENT PENALTY (SECTION 19132)

The underpayment penalty is assessed if a corporation fails to pay the amount of the tax due by the original return due date. The automatic seven-month extension of time to file a return is not an extension of time to pay the tax due.

The underpayment penalty will not be assessed if ALL of the following requirements are met:

- An extension of time to file has been granted.
- At least 90% of the tax due is timely paid by the original return due date.
- The remainder of the tax due is paid by the extended due date.

The underpayment is 5% of the unpaid tax due on the original return due date, plus .05% per month of the remaining tax, not to exceed 40 months during which the “remaining tax” is greater than zero. The aggregate amount of penalty imposed by this subdivision shall not exceed 25 percent of the total unpaid tax.

Once the underpayment penalty is assessed, it may be decreased in conjunction with any decrease in the assessed tax, but it may not be increased.

Note: This penalty is rarely assessed by an auditor, as it would normally be assessed by Central Office staff, when appropriate. An auditor may encounter the issue on a claim for refund, however.

8120 UNDERPAYMENT OF ESTIMATED TAX (SECTION 19142)

A penalty is imposed on the underpayment of tax if an installment is not paid in the correct amount, or in a timely manner. The penalty is computed on the underpayment of estimated tax from the date of the payment to the earlier of the date of payment, or the original due date of the return.

The underpayment of estimated tax is the difference between the amount due for each installment of the estimated tax and the amount actually paid or credited on or before the due date of that installment. In the case of any underpayment of estimated tax, an addition to tax is imposed based on the interest rate, for the amount of underpayment, for the period of the underpayment.

This penalty is rarely assessed by an auditor, as it would normally be assessed by Central Office staff, when applicable.

8130 INTEREST

The Franchise Tax Board computes the interest rate biannually.

Interest accruing after June 30, 1983 is compounded daily on:

- Unpaid tax
- Interest
- Certain penalties
- Unpaid water's-edge fees, when applicable.

Interest rates may be found on FTB Form 1138, Bank and Corporation Billing Information.

Generally, interest is computed as follows:

- For additional tax, interest is computed from the due date of the original return to the date paid.
- For additional water's-edge fees, interest is computed from the due date of the original return to the date paid.
- For delinquent and underpayment penalties and accuracy-related penalties, interest is computed from the due date of the return including extension.
- For all other penalties, interest is computed from the date of the notification, (the transaction date on the video) to the date paid.

Additional 2% Interest

Effective January 1, 1992, C corporations may be subject to 2% additional interest on underpayments if the cumulative unpaid tax for the taxable period exceeds \$100,000. To avoid the 2% additional interest, the corporation must pay the total underpayment amount within 30 days of notice. If assessed, the 2% additional interest will be computed on any unpaid amount for the taxable period.

Regarding the 2% additional interest, Revenue and Taxation Code Section 19521 conforms to Internal Revenue Code Section 6621 with modifications.

If the entire assessment is paid within 15 days of the original notification, no interest is charged from the notice date to the date of payment.

Overpayments are allowed interest from the date of the overpayment or the due date of the return, whichever is later, to a date that is within 30 days of the refund date. Interest is allowed on an originally filed return if the refund is not paid within 90 days of the filed date.

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Erroneous refund interest is charged from 30 days after the taxpayer is notified of the erroneous refund to the date the money is repaid. If the refund check is returned uncashed, no interest accrues.

THE AVON EXCEPTION

Every employee is responsible for being aware of the interest provisions affected by the federal court case, Avon Products, Inc. v. United States, 588 F. 342 (Avon), and insuring that accounts are corrected if the interest calculation results in a significant difference (* * *).

Generally, interest on the additional tax is assessed from the original due date of the return. The Avon Decision affects the interest starting date on the additional tax to the extent of an overpayment on the original timely or delinquent return if the overpayment was refunded or credited without interest, e.g., the refund or credit was made within 90 days after the return was filed or deemed filed.

Interest may not accrue on the additional tax, to the extent of the overpayment, for the period of time FTB held the overpayment and did not allow interest on the refund or credit.

When furnishing interest computations to taxpayers or when finalizing fully paid NPAs, it must be determined whether Avon applies.

Avon applies when all of the following are met:

- The additional tax is the result of an amended return or an NPA,
- There was an overpayment on the original return, and
- The overpayment was refunded or credited over to another year without interest allowed.

If Avon applies, interest is computed on the additional tax up to the amount of the overpayment starting from the date the overpayment was refunded or credited (use the account transaction date of the refund or credit). Interest is computed on the additional tax in excess of the overpayment from the original return due date.

If Avon applies, requests for interest calculations, account adjustments, and/or review of interest calculations may be made from Technical Support.

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8140 INTEREST ABATEMENT

Revenue and Taxation Code Section 19104(c) allows the Franchise Tax Board to abate all or any part of the assessed interest in certain cases. In order for interest to be abated, there must be a ministerial act on the part of FTB, which contributed to, or caused, the taxpayer to owe more interest than normal. For taxable or taxable years beginning on or after January 1, 1998, interest may also be abated when there is an unreasonable error or delay by an officer or employee of the Franchise Tax Board in performing a ministerial act.

FOR INTEREST ABATEMENT REQUESTED BY THE TAXPAYER:

If a taxpayer requests abatement of interest, the taxpayer must complete form [FTB 3701](#) and return it to the Taxpayer's Advocate Office.

Before a taxpayer's request for interest abatement can be made, the assessment must be due and payable (in billable status) and not merely a proposed deficiency assessment (pending, protest, or appeal status).

FOR INTEREST ABATEMENT INITIATED BY AN AUDITOR:

Discuss any possible interest waiver cases with your supervisor. If you believe the taxpayer is entitled to have a portion of the interest owed waived, refer the case to the Interest Abatement Coordinator. Include a memo stating the facts and circumstances of the case and your suggested recommendation.